No. 14875

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BEN GREENBLATT,

Appellant,

vs.

ERNEST R. UTLEY, Trustee in Bankruptcy for MOSES A. FLEMING, a bankrupt,

Appellee.

APPELLANT'S OPENING BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Rules

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APPELLANT'S OPENING BRIEF.

The within appeal is from an adverse judgment of the District Court of the United States, Southern District of California, sitting at Los Angeles, in a plenary action predicated upon an alleged bankruptcy preference.

Statement of Pleadings and Facts as to Jurisdiction.

(a) *Contents of Pleadings:* The pleadings herein are contained in Volume I of the Transcript of Record. (All references herein, unless otherwise noted, refer to pages and lines in Volume I of said Transcript of Record.)

The complaint alleges that one Moses A. Fleming, against whom an involuntary petition in bankruptcy was filed and an adjudication consented to, was adjudicated a bankrupt and that the appellee, Ernest R. Utley, at the

first meeting of creditors, was appointed Trustee of the bankrupt's estate [p. 2, line 17]. That on the 19th day of February, 1953, said bankrupt was indebted to appellant in the sum of $9,500.00 for (sub)division improvements installed on the real property belonging to the bankrupt [p. 3, line 6], and that on said date, the bankrupt assigned to appellant, payments in escrows, totalling said sum [p. 3, line 14]. That on said date said bankrupt was insolvent and that the appellant had reasonable cause to so believe and that the effect of said "delivery and payment" will enable the appellant to obtain a greater percentage of the debts owing to him, than other creditors of the same class [p. 3, line 20].

In answer thereto, the appellant as defendant, denied the material allegations of said complaint, as to the assignment of payments in escrow, the insolvency, knowledge thereof and effect thereof [p. 5, line 8], and as affirmative defenses, alleged that on the 12th day of December, 1952, the bankrupt was the beneficiary of a deed of trust in which appellant was Trustor, and which provides for the release of certain real property "one lot or parcel to be released upon the payment or release of $500.00" [p. 6, line 3]. That on said date, the bankrupt orally agreed to credit such deed of trust with the sum of $8,234.85, constituting the reasonable and agreed value of said (sub)division improvements installed on the real property belonging to the bankrupt, and as an additional affirmative defense, that any credit or transfer received by the bankrupt was effected more than four months prior to the adjudication in bankruptcy [p. 7, line 10], and that any such credit was for an existing consideration [p. 7, line 16], in that, at the time the same was transferred to or came into the possession of appellant, appellant was entitled

to and had a right of a mechanic's lien upon the property of said bankrupt, which lien and right thereto, was given up, released and relinquished by appellant at the time of and contemporaneously with the credit or receipt by him of any of the assets of the bankruptcy [p. 8, line 4].

(b) *Jurisdiction of the District Court:* The jurisdiction of the District Court herein, of necessity, must be predicated upon the statutory provision of the Bankruptcy Act, since diversity of citizenship is entirely lacking. Originally, jurisdiction in plenary actions was predicated upon Title 11, United States Code Annotated, Section 96(b). In 1950, said code section was amended and the provisions giving concurrent jurisdiction to State Courts with "any court of bankruptcy" was removed therefrom. At said time, such provision was added to *Section 67 of the Bankruptcy Act,* which was codified as *11 United States Code Annotated, Section 107, subparagraph "(e),"* of which provides, as follows:

> "For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

The general provision as to the jurisdiction of the District Court is found in *11 United States Codes Annotated, Section 46, subparagraph "(a),"* which provides as follows:

> "The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this title, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed

by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants."

The limitation requiring the consent of the defendant is inapplicable herein, since subparagraph "(b)" of said section excludes proceedings brought pursuant to Sections 96, 107 and 110 of Title 11. This includes the section and provision hereinbefore cited.

(c) *Jurisdiction of the Court of Appeal:* The jurisdiction of this Honorable Court to herein determine the within appeal, is predicated upon *28 United States Code Annotated, Section 1291,* which provides as follows:

"Final Decisions of District Courts:

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the District Court for the Territory of Alaska, the United States District Court for the District of the Canal Zone, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court."

Section 1294 of said code, provides that venue is in this Honorable Court, providing:

"Circuits in Which Decisions Reviewable:

Appeals from reviewable decisions of the district and territorial courts shall be taken to the courts of appeal as follows:

(1) From a district court of the United States to the court of appeals for the circuit embracing the district; . . ."

Statement of Case and Issues.

(a) *In the District Court:* Predicated upon the issues raised by the pleadings hereinbefore set forth, trial was had in the United States District Court, Southern District of California, before the Honorable Leon R. Yankwich, Judge presiding, commencing on Tuesday, the 17th day of May, 1955. All the evidence adduced at such trial was heard on said date and the matter was continued to Wednesday, the 18th day of May, 1955, for argument. At the conclusion of the argument, the Honorable Trial Judge indicated his holding and the reasons therefore. Since said reasons and the logic behind the same are considered in the "Argument" hereinafter contained, the same will not be repeated at this time.

Predicated upon the aforesaid reasons, the court made, signed and executed its "Findings of Fact and Conclusions of Law" on the 31st day of May, 1955 [p. 9, line 2]. Therein, the court found the fact of the adjudication in bankruptcy and the appointment of appellee as the duly appointed, qualified and acting Trustee [p. 9, line 23]. That on the 19th day of February, 1953, the bankrupt was indebted to appellant "for subdivision improvements previously installed on real property belonging to the bankrupt" [p. 10, line 15]. That on February 19, 1953, the appellant was indebted to the bankrupt "in a sum in excess of $33,000.00 . . . secured by two second deeds of trust, the (appellant) had purchased from the bankrupt" [p. 10, line 22]. That such indebtedness and security had been assigned to "one H. B. Benner to secure the payment by the bankrupt of an obligation in the sum of $6,000.00 owing from the bankrupt to said Benner" [p. 11, line 4]. That "on the 19th day of Febraury, 1953, the bankrupt's

remaining equity in said $33,000.00 note was in the sum of $9,500.00" [p. 11, line 11]. That on said 19th day of February, 1953, the bankrupt assigned his remaining equity and interest in said note and security to appellant "in full payment of the bankrupt's aforesaid antecedent indebtedness to the appellant in the sum of $9,500.00" [p. 11, line 17]. That on said date the bankrupt was insolvent, appellant had reasonable cause to so believe and that said transfer enabled appellant to obtain a greater percentage of his indebtedness than other creditors of the same class [p. 11, line 23]. The court also found that the allegations of appellant's two affirmative defenses are not true [p. 12, line 14], and an "omnibus" Finding "that all the controverted allegations of plaintiff's complaint and the defendant's answer inconsistent with the foregoing Finding of Fact, are hereby found to be untrue" [p. 12, line 20].

The court concluded that the appellant "was an unsecured creditor who obtained a voidable preference under *Section 60 of the Bankruptcy Act* [p. 12, line 25], and that appellee was entitled to recover from appellant said sum of $9,500.00, together with interest at the rate of 7% from the date of the filing of the action" [p. 13, line 5].

Interest as provided for in said judgment was computed in the sum of $183.40 [p. 14, line 17], and judgment was entered for said sums and taxable costs in the sum of $18.50 [p. 15, line 3]. Said judgment was entered on the 31st day of May, 1955 [p. 15, line 15], and on the 6th day of June, 1955, appellant herein filed his notice of appeal [p. 16, line 2]. Thereafter, and within the time required by law, appellant filed his "Designation of Contents of Record on Appeal" [p. 18, line 2].

(b) *In the Court of Appeal:* The records of this Honorable Court, of which judicial notice is taken, indicates the petitions of appellant and orders of this court authorizing the presentation of the appeal herein upon a typewritten transcript and the extension of time for the necessary preparation thereof.

The final portion and part of such typewritten record was filed with the Clerk of this Honorable Court on the 12th day of October, 1955, and this within brief was prepared and filed within the time provided by Rule 18 of the Rules of this Honorable Court.

(c) *Statement of Issues:* The legal problems herein involved, concern both facts and law. All of the problems thus presented, basically concern the primary issue. Did the appellant obtain a bankruptcy preference?

The appellant contends that he did not obtain a bankruptcy preference for two reasons, both of which present the specific issues upon which the "Argument" hereof is predicated.

First: *Does the transfer of property, the ownership of which is not in the bankrupt, constitute a preference?,* and

Second: *Does payment of a mechanic lienable claim, constitute a bankruptcy preference?*

The first issue thus presented, concerns itself primarily with the unique factual situation herein, which, as indicated in the "Statement of Facts" hereinafter contained, resulted in a third party actually compensating appellant from property actually in the name of such third party for services performed by appellant on behalf of the bankrupt.

The second matter and the more germane and basic issue, pertains to appellant, a general contractor, having performed services for which he was entitled to a lien upon the property of the bankrupt, who is compensated within the period wherein such lien is existing and may be asserted, who thereby, and in reliance upon such compensation, does not file such lien, is the forbearance in regard to said lien, and the non-assertion of the same, a present consideration, precluding the aforesaid credit and payment, from being a bankruptcy preference?

The balance of the within brief concerns itself with these two issues, which are presented by the consideration of the facts herein, and the law which appellant contends, is applicable thereto.

Specification of Error.

Pursuant to Rule 18, Section 2(d), appellant specifies as an error, the Finding of the court, hereinafter set forth, appellant asserting the same is erroneous, and not supported by substantial evidence.

(1) The court found:

> "That on the 19th day of February, 1953, the bankrupt assigned and transferred all of his remaining equity and interest in said $33,000.00 note, to-wit, $9,500.00, in full payment of the bankrupt's aforesaid antecedent indebtedness to the defendant in the sum of $9,500.00." [Finding VII, Tr. of Rec., Vol. I, p. 11, line 17.]

Such Finding is inconsistent with the evidence adduced at the trial, which was to the sole effect that the assignment of the credit, which was the basis for the claim and finding of the bankruptcy preference, consisted of the as-

signment by one H. B. Benner to the appellant of a credit upon a deed of trust given by appellant to the bankrupt. This credit was pursuant to instructions written by H. B. Benner, to whom the bankrupt, as beneficiary, had assigned the beneficial interest in said deed of trust [Pltf. Ex. 3]. The actual credit was the result of said instrument executed by said H. B. Benner and directed to the trustee named in the deeds of trust, and not the letter concurrently written by the bankrupt to the appellant informing him of the said credit allowed by said H. B. Benner, as the assignee of the beneficial interest in the deeds of trust [Pltf. Ex. 3].

This specification of error is made by reason of the fact that in the Argument, Point I, reference will be made to the fact that said H. B. Benner received an absolute and unfettered assignment [Deft. Ex. E], which, by its terminology, conveyed to him unconditionally, the beneficial interest in the deeds of trust. An innocent third party purchasing the same for value, would have acquired the entire interest of the beneficiary as against the equitable claims of the bankrupt. The rights of the bankrupt, subsequent to such assignment in said deeds of trust, were equitable and not legal. The legal credit given to the appellant was by said H. B. Benner, who, on said 19th day of February, 1953, "assigned and transferred said credit," to the appellant, the amount of the deeds of trust that were equal to the remaining equity of the bankrupt therein.

H. B. Benner and not the bankrupt, was the assignor and transferor. The rights assigned and transferred by him were at said time, his said legal property, although the amount thereof was equal to the equitable rights of the bankrupt therein.

Statement of Facts.

Moses A. Fleming, the bankrupt, is an attorney at law [Rep. Tr. p. 102, line 14].[1] Appellee, Ernest R. Utley is the duly appointed, qualified and acting Trustee in Bankruptcy. Appellant Ben Greenblatt is a licensed general contractor under the laws of the State of California [Rep. Tr. p. 67, line 20, to p. 68, line 2].

Said bankrupt, in addition to some four hundred acres of land, owned by him in Riverside County, owned certain property in Los Angeles County, including approximately twenty acres near the City of Baldwin Park [Rep. Tr. p. 6, line 7; p. 18, line 21].

Approximately May 28, 1952, or shortly prior thereto, said bankrupt and appellant discussed the sale of approximately eighteen of said acres, it being appellant's purpose at said time, to subdivide said land so purchased, improve the same with houses, and sell the same to the public. The sale thereof was consummated through an escrow dated May 28, 1952, held by the Escrow Guarantee Company [Rep. Tr. p. 7, line 11; Pltf. Ex. "1"]. During the negotiations of said sale, the bankrupt requested appellant to arrange to have the necessary improvements, such as streets, curbs and utilities, installed upon the lands retained by the bankrupt, at the same time appellant did the same, the bankrupt stating that the doing of the same would be advantageous to him, both as to the doing of the work and the costs therefor [Rep. Tr. p. 64, line 16]. The appellant indicated that he would be agreeable to so doing, provided he was credited with his costs upon the contemplated encumbrances that would con-

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[1]All citations contained in this subject matter, refer to Volume II (Reporter's) Transcript of Proceedings.

stitute part of the purchase price [Rep. Tr. p. 64, line 23]. The agreement of sale as set forth in the escrow instructions, provided for a total consideration to be paid by appellant of $3,000.00 cash and $36,000.00 payable at the rate of $500.00 for each lot as the same and the house thereon, were sold [Rep. Tr. p. 8, line 3; Pltf. Ex. "1"]. This sum was to be evidenced by two notes and secured by two deeds of trust [Deft. Exs. "D" and "H"]. Such escrow instructions also provided:

> " 'Seller agrees to give credit on such hereinbefore mentioned Deed of Trust, upon completion of work on the improvements upon the tract mentioned herein, for the following improvements which will be completed by buyer, paid for by buyer, for account of the seller and you will not be further concerned therewith. Utilities and improvement of La Sena Avenue from Olive Street to the north line of the alley. Utilities and improvement of the west one-half of La Sena Avenue to the South line of Lot 18. Improve alley running from La Sena Avenue to Azusa Canyon Road. Utilities and improvement of Nubia Street within the lines of this tract.' "

The approximate two acres retained by the bankrupt is indicated upon Defendant's Exhibit "A" [Rep. Tr. p. 20, line 2].

> At the request of the attorney for the appellant, the bankrupt indicated by "red" pencil on said Exhibit "A," the land retained by him [Rep. Tr. p. 21, line 4], which consists of two parcels of land thereon designated "A" and "B." Subsequently, the appellant indicated on said exhibit, an additional piece of property retained by the bankrupt and designated the same as "F" [Rep. Tr. p. 65, line 20].

The work contemplated and described in general, under the escrow instructions, was commenced in July, 1952 [Rep. Tr. p. 57, line 19], and was concluded approximately January 6, 1953 [Rep. Tr. p. 57, line 23; p. 76, line 16].

By December 12, the work had sufficiently progressed that appellant was able to have computed the costs thereof, chargeable to the bankrupt and sent him a bill therefore [Rep. Tr. p. 28, line 13; Deft. Ex. "B"]. These charges were prepared for the appellant by Tom Gramm, a licensed surveyor and engineer [Rep. Tr. p. 67, line 13]. The work thus done was indicated upon Defendant's Exhibit "A" as items "C," "D," and "E," and consisted of the installation of utilities, improvements and paving on La Sena Avenue, from Olive to the north line of the alley, the west of La Sena Avenue to the south line of Lot 18, and of Nubia Street, within the lines of the tract, and also the paving of the alley running from La Sena Avenue to Azusa Canyon Road [Rep. Tr. p. 26, lines 20, 24]. Where utilities were placed as indicated in said Defendant's Exhibit "A," appellant caused the same to be put in and paid therefore [Rep. Tr. p. 27, line 6].

The bankrupt was dissatisfied with the amount of the charges and said he was going to look into the reasonableness thereof [Rep. Tr. p. 10, line 23]. Originally, as provided for in the written escrow instructions, the appellant desired a credit on the amount of his billing of approximately $8,200.00 [Rep. Tr. p. 29, line 1]. Appellant contends that the bankrupt agreed to the giving of such credit [Rep. Tr. p. 68, line 22], which discussion

occurred when appellant delivered to the bankrupt Defendant's Exhibit "B" [Rep. Tr. p. 68, line 11], on December 12, 1952 [Rep. Tr. p. 70, line 3].

The appellant had theretofore learned that the bankrupt had assigned the two promissory notes and deeds of trust to one H. B. Benner [Exs. "E" and "H"]. Such assignment was made to secure to Mr. Benner, the payment of $6,000.00 for certain property sold by him to the bankrupt at the time of the assignment. During the discussion of December 12, 1952, appellant requested the bankrupt to notify Mr. Benner to give appellant credit for the claim then made upon said promissory notes [Rep. Tr. p. 68, line 22]. The bankrupt contended that thereafter, several discussions were had as to the reasonableness of appellant's charges [Rep. Tr. p. 11, line 7], and also the bankrupt had noted that certain of appellant's houses were finished and occupied, and requested that he be paid the sum of $500.00 for each house [Rep. Tr. p. 14, line 22].

It is apparent that some conflict existed between the appellant and bankrupt. Such dispute existed upon the claims of the bankrupt against the appellant for $500.00 on each house allegedly sold. Factually, no house was sold since, prior to February 19, 1953, the escrow for such sales could not be closed for lack of partial reconveyance [Rep. Tr. p. 94, line 21], and the reconveyances could not be obtained until after the recordation of the deeds of trusts and assignments [Rep. Tr. p. 96, line 8]. None of the escrows remained unclosed due to the instructions of the appellant [Rep. Tr. p. 97, line 7].

During the first part of December, 1952, appellant purchased from the bankrupt, the four lots that are designated "A" of Defendant's Exhibit "A" [Rep. Tr. p. 21, line 24; p. 70, line 13; Deft. Ex. "A"]. Shortly thereafter, he was notified by the lending institution handling the matter, that there was a lien on the land held by a Mr. Velez. Inquiry disclosed that the bankrupt was indebted to Mr. Velez in the sum of $1,300.00 [Rep. Tr. p. 91, line 12]. On December 30, 1952, appellant and the bankrupt met in the office of Burke Mathes, Esq. [Rep. Tr. p. 71, line 15], at which time, for the purpose of clearing said lien and obtaining good title to said four lots, appellant executed his check in the sum of the indebtedness [Deft. Ex. "C"], which was delivered to the bankrupt upon the expressed agreement that the same would be credited upon the notes and deeds of trust [Rep. Tr. p. 72, line 15]. A collateral instrument executed at the same time indicates this transaction occurred about December 30, 1952 [Deft. Ex. "I"]. A few days later, appellant sought to obtain a verification of the two credits to which he was entitled [Rep. Tr. p. 74, line 12]. When he failed to obtain the same and concurrently with the conclusion of the improvement work on the tract on January 6, 1953, appellant wrote a letter to Mr. Benner requesting all matters be held in abeyance until the credits which he sought, were given to him [Deft. Ex. "F"]. Thereafter, the bankrupt informed appellant that Mr. Benner was agreeable to the credits being allowed appellant, providing an itemization of his charges be given. There-

upon, the appellant wrote to Mr. Benner and annexed thereto, such itemization [Deft. Ex. "G"].

The relationship between the parties appears to have become strained about the period of the second purchase in December, 1952, by the appellant. The bankrupt as an attorney, knew that the appellant as a general contractor, had a right of lien [Rep. Tr. p. 40, line 17]. A few days after he mailed the letter to Mr. Benner, on January 6, 1953, appellant went to Mr. Benner's home and indicated he would file a Mechanic's Lien upon the Fleming property if he did not get the credit he claims he was entitled to [Rep. Tr. p. 75, line 10]. He had informed Mr. Fleming of his right of lien during the month of December, 1952 [Rep. Tr. p. 75, line 21]. The bankrupt did not have a definite recollection, but conceded that the appellant "may have said" that he would file a Mechanic's Lien on the bankrupt's property [Rep. Tr. p. 36, line 1]. On January 12, 1953, the appellant obtained written releases from the materialmen who furnished the asphalt, sand and gravel, used in the improvement of the bankrupt's property [Rep. Tr. p. 76, line 18; Deft. Ex. "J"]. He showed the same to the bankrupt [Rep. Tr. p. 77, line 11], at which time he specifically stated that he was going to prepare and file a Mechanic's Lien on the bankrupt's property [Rep. Tr. p. 77, line 22]. He continued expressing his intention to do so [Rep. Tr. p. 78, line 24], until his demands were acquiesced in on February 19, 1953.

On February 19, 1953, the appellant, the bankrupt and Mr. Benner met in the office of Mr. Gary of the escrow Guarantee Company, the trustee in the Deeds of Trust, and the escrow holder, at which time there was reduced to writing, the agreement to credit the appellant with $9,-500.00 on the deeds of trust [Pltf. Exs. "2" and "3"]. This is the approximate agregate of of the two claims of appellant of $8,200.00 for the improvement work and utilities done upon the bankrupt's property and the $1,-300.00 paid to release from the Velez lien, the portion of the property, sold by the bankrupt to appellant in December, 1952. The appellant has received no other compensation for the utilities and improvement work done by him, nor has he been repaid in any manner for the monies advanced for the payment of the Velez note and lien [Rep. Tr. p. 80, line 2].

The aforesaid credit of $9,500.00 is the basis upon which the "complaint (herein) to recover (a) voidable preference under the provisions of Bankruptcy, Section 60 N," is predicated [Tr. of Rec., Vol. I, pp. 2-4, incl.]. As alleged in said complaint, an involuntary petition in bankruptcy was filed against said Moses A. Fleming on the 28th day of May, 1953, and a consent to adjudication was filed by him on the 29th day of May, 1953.

ARGUMENT.

I.

That the Transfer of Property, the Ownership of Which Is Not in the Bankrupt, Does Not Constitute a Bankruptcy Preference.

As alleged in the complaint, the complained of bankruptcy preference, consisted of credits allowed appellant on the 19th day of February, 1953, upon deeds of trust [Tr. of Rec., Vol. I, p. 3, line 14].

The Findings of the District Court specifically indicate that said deeds of trust had theretofore been assigned to "one H. B. Benner to secure the payment of an obligation of $6,000.00 owing from the bankrupt to said Benner" [Tr. of Rec., Vol. I, p. 11, line 4]. On said February 19, 1953, the residual equity of the bankrupt in said deeds of trust was $9,500.00 [Tr. of Rec., Vol. I, p. 11, line 11]. The District Court found that on said date "the bankrupt assigned and transferred all of his remaining equity and interest . . . in full payment of the bankrupt's aforesaid antecedent indebtedness to the defendant in the sum of $9,500.00" [Tr. of Rec., Vol. I, p. 11, line 17]. It has been hereinbefore indicated, in the Specifications of Error, that said Finding is inconsistent and incompatible with the evidence adduced at the trial. On said 19th day of February, 1953, the bankrupt wrote to the appellant, a letter introduced into evidence, and on said date, said H. B. Benner, in writing instructed the trustee named in the deeds of trust, such instruction providing for a credit being allowed thereon, in favor of the

appellant [Pltf. Exs. "2" and "3"]. While the letter indicates the benefit received by the bankrupt, namely, the "full payment . . . of (appellant's) bill for all paving authorized and due to (appellant and) reimburse (appellant) for $1,300.00 (appellant) advanced to pay off the Velez claim" against the bankrupt, the actual credit received by the appellant therefore was a direct grant from said H. B. Benner in his letter of instruction to the Escrow Guarantee Company. At said time the assignment from the bankrupt to said H. B. Benner was a good and valid assignment, and the actual title to the deed of trust and to the beneficiaries' interest therein, was in said H. B. Benner.

It is respectfully submitted that to constitute a preference, the credit or payment must have been given by the bankrupt or his agent, and not by a third party, such as said H. B. Benner.

In the case of *Western Tie & Timber Company v. Brown* (1905), 196 U. S. 502, the bankrupt was indebted to a corporation whose laborers purchased supplies from him. Periodically he rendered to the corporation a statement of the amounts due from such laborers, which it deducted from their wages and remitted to him in an aggregate sum. During the period within four months prior to bankruptcy, such sum so collected from the laborers had not been remitted, and upon bankruptcy, the corporation credited the same upon monies due it from the bankrupt. The court concluded at page 510 of the decision, that no voidable preference was thereby created and reversed the holding of the District Court, predicated upon the assumption that the aforesaid transaction constituted a voidable preference.

Following said case and to the same effect is the case of *Rector v. City Deposit Bank* (1906), 200 U. S. 415, 419.

Predicated upon this general principal, there have been many cases, two of which arose in the Ninth Circuit, and therefore are specifically applicable.

In the case of *O. L. Shafter Estate Co. v. Mooney* (1927), 18 F. 2d 836, the defendant owned a number of ranches which it rented on an annual basis to dairymen, furnishing to the dairymen the necessary stock. The defendant also allowed such dairymen to sell with defendant's consent, the good will and privilege of renewing the leasehold. Within four months prior to bankruptcy, the bankrupt, one of the defendant's tenants, sought to sell his good will and leasehold rights, and the defendant required the payment of all delinquent rentals, as a condition to its consent. The purchaser made such payments to the defendant. This Honorable Court held at page 837:

> "The truth is that, in accepting Hall as lessee and requiring him to buy the equipment from Bartholomew, defendant assisted Bartholomew in getting more for what he owned than would otherwise have been possible. True, it might have permitted him also to capitalize the so-called good will; but that would have been a matter of grace, and not of right. Even if we assume that, in exacting $1,700 from Hall as a condition to giving him a lease, defendant acted harshly toward Hall, Bartholomew's creditors are not in position to complain, in the absence of proof that some part of that sum was for property owned by Bartholomew, or was in consideration for a right vested in him. To constitute a preference, the payment in question must have been out of funds belonging to the bankrupt, and have operated to diminish his estate."

In the case of *In re Zaferis Bros. & Co., Ltd.* (1933), 67 Fed. 140, and order of the Referee, predicated upon an alleged preference, was affirmed by the District Court. Such order was based upon the transaction, whereby a stockholder who had guaranteed the bankrupt's obligations to a bank, transferred credits to the bankrupt's account to reduce its overdraft and took the bankrupt's unsecured checks for the amounts so deposited. It was held that the same did not constitute a preference. This Honorable Court observed at page 141:

> "It therefore lacked the primary element of a preference, that of a transfer of the bankrupt's property. Newport Bank v. Herkimer Bank, 225 U. S. 178, 32 S. Ct. 633, 56 L. Ed. 1042 (1912) . . ."

In each of the aforegoing cases, the monies that were the subject of the transfer were legally the property of a third person, in which the bankrupt had an equitable right. The same situation is applicable herein to the beneficiary's interest under the deeds of trust. The form of assignment used for the conveyance thereof, was absolute in terminology [Deft. Ex. "E"]. But an equitable right remained in the bankrupt to the residue of the proceeds thereof, after Mr. Benner and the other parties entitled thereto, had been paid in full.

It is respectfully submitted that under the facts and law applicable thereto, the granting of said credit by H. B. Benner to the appellant, consisted of the transfer of property, the legal ownership of which was not in the bankrupt, and does not constitute a bankruptcy preference.

II.

That the Payment of a Mechanic Lienable Claim, Does Not Constitute a Preference.

The within point is more germane and more general in its application than the preceding point. It is predicated upon the assumption, without any concession, that the credit or payment, which is the basis of the alleged preference, was made from assets legally belonging to the bankrupt. Since it is less technical and more equitable in scope, than the preceding point of law, it is respectfully urged, in preference to, but without diminution of said preceding point of law.

The facts are without contradiction that the appellant, a general contractor, licensed as such by the State of California, performed or caused to be performed, mechanic lienable work, for and on behalf of the bankrupt. As indicated in the Statement of Facts, such work consisted of the paving and installation of utilities, either jointly or severally, upon property belonging to the bankrupt.

Section 1184.1 of the Code of Civil Procedure of the State of California provides:

> *"Improvement of lots or tracts of land:*
>
> "Any person who, at the instance or request of the owner (or any other person acting by his authority or under him, as contractor or otherwise) of any lot or tract of land, grades, fills in, or otherwise improves the same, or the street, highway, or sidewalk in front of or adjoining the same, or constructs or installs sewers or other public utilities therein, or constructs any areas, or vaults, or cellars, or rooms, under said sidewalks, or makes any improvements in connection therewith, has a lien upon said lot or

tract of land for his work done and materials furnished. (Added Stats. 1951, c. 1159, p. 2943, Section 1.)"

The work done upon the land of the bankrupt was part of general improvements on the entire tract, including the land sold by the bankrupt to the appellant, and those retained by the bankrupt, which work was completed during the first week of January, 1953. The time in which the appellant, as a general contractor and the original contractor herein, could file his lien, is governed by *Section 1193.1(c) of said Code of Civil Procedure,* which provides, as follows:

> *"Notice of completion; time for filing.* The owner shall within 10 days after the completion of the work of improvement file for record a notice of completion as provided in subdivision (f) of this section. If such notice be so filed, then, except as to any persons who were required to file a claim of lien as provided in subdivision (b) of this section, every original contractor must within 60 days after the date of filing for record such notice, and every person, other than an original contractor, claiming the benefit of this chapter must within 30 days after the date of filing for record such notice, file for record his claim of lien. If such notice be not so filed, then, except as to any persons who were required to file for record claims of lien as provided in subdivision (b) of this section, all persons claiming the benefit of this chapter shall have 90 days after the completion of such work of improvement within which to file their claims of lien."

The work of improving the tract as a whole, was completed on the 6th day of January, 1953 [Rep. Tr. p. 57,

line 23; p. 76, line 16]. Sixty days thereafter would have elapsed on the 8th day of March, 1953. The lien of the appellant could therefore have been asserted on the 19th day of February, 1953, when the alleged preference was allowed to him by a credit upon the deed of trust then owned by Mr. H. B. Benner.

On the 19th day of February, 1953, the lien of the appellant for the improvements placed by him upon the land of the bankrupt, consisting of pavement and public utilities, were still lienable for a reason other than the period of time. Such work is lienable under *Section 1184.1 of the Code of Civil Procedure, supra,* and pertaining to improvements requiring acceptance by governmental authorities, the lien for the work done in regard thereto, and the time in which the same could be filed, is further governed by *Section 1193.1(e)* of said *Code of Civil Procedure,* providing as follows:

> *"Public governmental work; acceptance.* If a work of improvement is of the character referred to in Section 1184.1 of this code and is subject to acceptance by any public or governmental authority, the completion of such work of improvement shall be deemed to be the date of such acceptance."

The germane question thus presented, is, since the appellant, on February 19, 1953, was entitled to assert and could have legally asserted a mechanic's lien upon the real property of the bankrupt, did his acceptance of the credit in satisfaction of his lienable claim, constitute a preference? It is respectfully submitted that the same did not.

In the case of *San Mateo Feed & Fuel Co. v. Hayward* (1945), 149 F. 2d 875, Mr. Justice Denman (now Chief and Senior Judge of our Ninth Circuit), set forth the contentions of the defendant therein, at page 876, as follows:

> "As we understand appellants' contentions they are, in effect, (a) That since the materialmen's lien disappeared to the extent the debt for the materials was lessened by the payments, there was a detriment to the materialmen which constituted a present consideration for the delivery of the checks; and (b) the checks were in fact paid under an agreement made long before the four months' period between the materialmen, the owner, and the contractor, by which the contractor agreed that the owner should pay the materialmen for the materials delivered to the building out of the amounts due from the owner to the contractor when they became due, and hence the delivery of the checks was a transaction between the owner and the materialmen in discharge of an obligation of the former to the latter."

In regard to said contentions, the court held immediately thereafter:

> "(a) With regard to the first contention, the lien extinguished was not upon the property of the bankrupt and hence its extinction caused no increase in the bankrupt's estate . . . (b) With regard to the claimed prior agreement that the checks were delivered in payment of a direct obligation of the owner to the materialmen, assuming that such a payment would not be a preference, the evidence does not show such an agreement was made . . ."

Although, factually contrary to the cause herein, the law thus established is specifically applicable, since: (a) The property involved herein is the property of the bankrupt, and hence, the extinction of the inchoate lien caused

an increase in the bankrupt's estate, and (b) The prior agreement as to the allocation, purpose and objective of the credit, is expressly set forth in the written escrow instructions of May 28, 1952, signed by the parties and constituting an agreement between them to the effect that Bankrupt as seller [Pltf. Ex. "1"], agrees to give defendant as contractor, a credit upon the deed of trust therein described for the improvement of the real property thereafter remaining in the name of such seller.

The rule inferred in the foregoing case and contended for herein by the appellant, namely, the payment of an enforceable, although inchoate lien within the four months' period, does not constitute a preference, has been adhered to by the Honorable Court of Appeals of the Ninth Circuit.

In the case of *Jackson v. Flohr* (W. D. Wash. N. D., 1954), 119 Fed. Supp. 305, the court reviews several cases dealing with mechanic's liens, including the case of *San Mateo Feed & Fuel Co. v. Hayward, supra,* and cites with approval the case of *Seattle Association of Credit Men v. Daniels* (1942), 15 Wash. 2d 393, 130 P. 2d 892, at page 308 of the District Court's Opinion, as follows:

> " 'If respondents (construction contractors supplying work and materials) had an enforceable lien, even though inchoate, for the work performed and materials furnished, the payment (within the four-month period) was not a preference.' (15 Wash. 393, 130 P. 2d 894.)"

To the same effect is 4A *Remington on Bankruptcy* 112, *Section 1664,* particularly the current supplement thereto, page 22.

Also adhering to said principle is the case of *In re Lynn Company Coal Co.* (1908), 168 Fed. 998, 999.

The general rule that the payment of an enforceable statutory lien does not constitute a bankruptcy preference, is set forth in 8 *Corpus Juris Secundum* 781, Bankruptcy, *Section 220(e),* wherein it is set forth

> "In view of the general rule that depletion or diminution of the estate available for creditors is an essential element of a preference (see *supra,* Section 220a), no preference results, where there is not a diminution of the assets available for general creditors, from the enforcement of a valid, existing lien, from a payment to discharge a valid lien, . . ."

Numerous cases are cited in support therefor, and in the prior note upon said subject matter, found in 7 Corpus Juris 164, note 65. The cases thus cited, include several pertaining to Mechanic's Liens (*Public National Bank & Trust Co. v. Fortinberry* (Tex. Civ. App.), 53 S. W. 2d 113, and *Russell v. Mayfield Lumber Co.,* 158 Ky. 219, 164 S. W. 783). The acceptance by the Federal courts of this rule is indicated by many cases.

In the case of *Root Mfg. Co. v. Johnson* (1914), 219 Fed. 397, the waiver of a Materialmen's Lien was held to preclude the transaction from being a preference, the court holding at page 401:

> ". . . it is unquestionable that the statute does not denounce as preferential all payments so obtained by a creditor within the four-months period; that payment may lawfully be accepted for discharge of a valid lien, either legal or equitable; that payments or benefits obtained in various other transactions, as exemplified in recent decisions (Western Tie & Lumber Co. v. Brown, 196 U. S. 502, 25 Sup. Ct. 339, 49 L. Ed. 571; Newport Bank v. Herkimer Bank, 225 U. S. 178, 32 Sup. Ct. 633, 56 L. Ed. 1042; Continental

> Trust Co. v. Chicago T. & T. Co., 229 U. S. 435, 33 Sup. Ct. 829, 57 L. Ed. 1268), . . ."

This decision was approved on appeal to the United States Supreme Court, in the case of *Johnson, Trustee etc. v. Root Mfg. Co.* (1916), 241 U. S. 160.

In the case of *Bachner v. Robinson* (1939), 107 F. 2d 513, the creditor had a lien upon the balance of the leasehold of the bankrupt for unpaid rent. In holding that a payment made in satisfaction of such lien and to transfer such leasehold did not constitute a preference, the court held at page 515:

> ". . . In reality, therefore, the lessor held a position analogous to that of a secured creditor; it is much as though there had been a mortgage on the leasehold which the purchaser insisted should be paid before he would take title. The payment of a secured claim is not a preference. Johnson v. Root Mfg. Co., 241 U. S. 160, 36 S. Ct. 520, 60 L. Ed. 934; Irving Trust Co. v. Bank of America Nat. Ass'n, 2 Cir., 68 F. 2d 887, certiorari denied, 292 U. S. 628, 54 S. Ct. 630, 78 L. Ed. 1482 . . ."

To the same effect is the recent case of *Gibson v. Central National Bank of McKinney* (1948), 171 F. 2d 398, 400.

Other decisions holding that the payment of a mechanic lienable claim does not constitute a bankruptcy preference, are *In re Conrad* (Kan., 1934), 26 A. B. R. (N S), 600; *Vanderlip v. Walker* (1932), 144 Misc. 629, 259 N. Y. Supp. 289; 21 A. B. R. (N. S.) 638; and *Public National Bank & Trust Co. v. Fortinberry* (1932), 53 S. W. 2d 113, 26 A. B. R. (N. S.) 246.

The basic contention of appellant in this appeal is that on February 19, 1953.

(a) Appellant Had a Good, Valid and Existing Mechanic's Lien, Recognized by the Constitution and Statutes of the State of California, for the Work, Services and Labor Performed by Appellant Upon and for the Benefit of the Bankrupt's Land.

The constitution, statutes and decisions of the appellate courts of the State of California, particularly that of the Supreme Court of said state, recognize such principle.

In the case of *English v. Olympic Auditorium, Inc.* (1933), 217 Cal. 631 (20 P. 2d 946, 87 A. L. R. 1281), in discussing the nature and effective date of a mechanic's lien in the State of California, the Supreme Court of said state, held at page 638:

> " 'The Constitution of the state of California (Art. XX, sec. 15), is the basis of the Mechanics' Lien Law, and is as follows: 'Mechanics, materialmen, artisans, and laborers of every class shall have a lien upon the property upon which they have bestowed labor or furnished material, fror the value of such labor done and material furnished; and the legislature shall provide, by law, for the speedy and efficient enforcement of such liens.' The language of the foregoing provision of our Constitution is clear and positive and gives a direct lien on the property upon which the classes named therein have bestowed labor or furnished material to the extent of the value thereof. In carrying out the above constitutional mandate, the legislature has provided by section 1183 of the Code of Civil Procedure that mechanics and materialmen shall have a lien upon the property on which they have bestowed labor and material, thus following the constitutional provision . . .
>
> "Mazzera v. Ramsey, 72 Cal. App. 601 at page 606 (238 Pac. 101, 103), quotes with approval from Peo-

ple v. Moxley, 17 Cal. App. 466, 468 (120 Pac. 43), as follows: *'The lien of a mechanic or materialman is a constitutional right and attaches to the structure as the material is furnished or labor performed.* The statutory procedure enacted for the enforcement of such right has reference only to the remedy.' (See, also, Siegel v. Hechler, 181 Cal. 187 (183 Pac. 664).)" (Emphasis ours.)

Pursuant to said decision, the mechanics' lien of the appellant, under the Constitution and statutes of said state, attached to the property of the bankrupt in July, 1952 [Rep. Tr. p. 57, line 19], when the improvement work was commenced.

(b) That the Appellant Had the Right to Perfect Said Lien.

As hereinbefore indicated, under the statutes of the State of California, appellant's right to perfect said lien had not expired on said 19th day of February, 1953, under any statutory theory. The same was for public improvements and utilities requiring acceptance by governmental authorities and also the requisite ninety-day period consisting of a cessation of labor for thirty days and a statutory period of sixty days in which a contractor could enforce his claim, had not expired. Factually, the said sixty-day period had not expired from the conclusion of the making of the improvements during the first week of January, 1953.

(c) That Concurrently With the Receipt of the Credit or Payment, the Appellant Satisfied and Forewent His Said Statutory Lien.

If payment had not been made, there appears no question that the appellant would have asserted his lien. He had a legal right so to do, and indicated his intention to

do so [Rep. Tr. p. 75, lines 10, 21; p. 77, line 22, to p. 78, line 24]. The bankrupt, an attorney, knew of such right of lien [Rep. Tr. p. 40, line 17], and concedes that the appellant "may have said" that he would file such lien [Rep. Tr. p. 31, line 1]. Appellant, in substance, released said lien as one of the considerations for the credit or payment received by him, since the lien could no longer be asserted after payment had been received or the obligation had been satisfied. The fact that the satisfaction of said lien was material, is indicated by the releases obtained from the materialmen [Rep. Tr. p. 76, line 18; Deft. Ex. J].

(d) By Reason of the Release of the Bankrupt's Land From the Mechanic's Lien That Could Have Been Asserted by the Appellant, There Was No Bankruptcy Preference Herein.

Had the mechanic's lien of the appellant been perfected by reason of non-payment, such Constitutional and statutory lien would have been a preferred claim or charge upon the property of the bankrupt, that would have resulted in the dimunition of his estate, in regard to unsecured creditors. By reason of the factual situation herein, such estate was not diminished by the credit or payment to the appellant. Factually, appellant as a "secured" creditor, gave up a security equal to the amount of the credit or payment received by him, which resulted in the transaction herein, not effecting the amount of the estate of the bankrupt, particularly that portion thereof that was eventually distributed to unsecured creditors. This is the basic reasoning for the holdings of the various Federal cases hereinbefore cited.

It is respectfully submitted that when the mechanic lienable claim of the appellant was satisfied by the credit

or payment of February 19, 1953, and by reason thereof, said lienable claim was not thereafter pursued and asserted. Such credit and payment did not constitute a preference.

Conclusion.

It is respectfully submitted that under the facts and law applicable thereto:

(a) The credit given by Mr. Benner was the allowance of a credit by a third person and not involving the property of the bankrupt and hence, could not constitute a bankruptcy preference, or

(b) The appellant having a mechanic lienable claim recognized by the Constitution, statutes and decisions of the State of California, and such claim being a valid lien upon the property of the bankrupt which could have been asserted and perfected on the day that the credit was allowed, the payment of such credit on said date, resulting in the extinction of such lien, was for a present consideration, did not result in the diminution of the estate of the bankrupt, and therefore could not constitute a bankruptcy preference.

For the foregoing reasons it is further respectfully submitted that the judgment of the District Court, holding and adjudicating that the appellant had received a bankruptcy preference, should be reversed, and the cause remanded for further proceedings in conformity with the law, hereinbefore contained.

Respectfully submitted by,

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